



CALIFORNIA DEPARTMENT OF INSURANCE  
JOHN GARAMENDI, COMMISSIONER

**FOR RELEASE:**  
September 2, 2003 (#102)

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**GARAMENDI RESPONDS TO CONFERENCE COMMITTEE QUERY  
ON WORKERS' COMPENSATION PREMIUM REDUCTIONS**

August 29, 2003

Honorable Senator Alarcon  
Member, Workers' Compensation Conference Committee  
State Capitol  
Sacramento, CA 95814

RE: Reductions in premiums to employers

Dear Senator Alarcon:

You asked during the hearing on workers' compensation reform what reductions in the system's cost drivers would be necessary to reduce premiums. You also asked if I, as Insurance Commissioner, had the power to order reductions. I do not have that authority. Moreover, lower premiums will result only from real and substantial reductions in the costs of the workers' compensation system.

The system is plagued with extraordinary inflation in the cost of medical services, as well as unnecessary legal and administrative expenses. The estimated inflation rate in the pure premium<sup>1</sup> costs for the year 2003 alone is 20%. To allow insurers to keep pace with this inflation rate, an advisory pure premium rate increase of 10.5% was approved, going into effect on January 1, 2003 for policies beginning or renewing on or after that date. An additional advisory rate increase of 7.2% was approved and became effective July 1 for policies beginning or renewing on or after that date. And finally, last month the WCIRB recommended yet another advisory pure premium rate increase of 12% to become effective January 1, 2004 for policies beginning or renewing on or after that date. If approved, this latest hike would bring the total increase since December 2002 to 32.7%.

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<sup>1</sup> "Pure premium" is the cost of claims only. It does not include any provision for expenses such as overhead, federal taxes, or profit. The "pure premium rate" is not the rate charged to individual policyholders. The rate charged to policyholders is a combination of the pure premium rate plus insurer expenses. Additionally, because there are over 500 workers' compensation job classifications reflecting different hazards and exposure, the individual policyholder's rate reflects the relative loss experience of the classifications. In short, an average reduction in the pure premium rate will have differing impacts on individual policyholders' premiums.

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Honorable Richard Alarcon  
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It is estimated that every \$250 million in reduced system costs equates to a 1% reduction in pure premium costs. Accordingly, to eliminate the need for the prospective 12% increase, costs need to be reduced by 10.7%, or \$2.7 billion. To eliminate the July 1, 2003 increase as well as the prospective 12% increase, costs need to be reduced by a total of 16.7%, or \$4.2 billion. And to eliminate both of those increases plus the January 1, 2003 increase, effectively returning pure premium rates to July 2002 levels, costs would need to be reduced by a total of 24.6%, or \$6.2 billion.

The current workers' compensation market is dysfunctional. The return to a competitive and robust market requires stable and predictable medical, legal, and administrative costs. The committee discussion leads me to believe that it may draft a law that mandates a reduction in the premiums for workers' compensation. There can be no reduction in premiums below the actual costs of paying claims, legal costs, administrative costs and a reasonable profit. Any requirement to lower premiums below these real expenses will create a market crisis similar to the electrical energy crisis of 2000. Furthermore, private companies will flee California leaving the State Compensation Insurance Fund, an already severely stressed organization, as the only source of workers' compensation insurance. I strongly urge you to consider this conundrum.

We all understand how difficult it is to achieve cost reductions of \$6.2 billion. Nonetheless, I believe that we have no choice but to do so. During the hearings the committee and the public heard the serious impact that this crisis has on businesses, governments, and non profit organizations in California. I explained in my testimony how significant cost reductions could be achieved and refer you to the interconnected proposals that I presented to the committee.

Respectfully yours,



JOHN GARAMENDI  
Insurance Commissioner

cc: The Honorable Gray Davis  
Members, Workers' Compensation Conference Committee

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